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TO: The Board of Directors and Management of Michigan state-chartered credit unions

SUBJECT: 2002 Third Quarter Financial Results

OFIS compiles call report information to monitor Michigan state-chartered credit unions, both individually, and in the aggregate. The purpose of this letter is to share some overall industry trends and highlight certain areas of particular concern based on the September 30, 2002 call report filings.

Summary

Overall, Michigan's 280 state-chartered credit unions remain in sound financial condition. Credit union membership increased slightly more than 1% for the quarter and is over 2.65 million. Total assets increased 5.3% for the quarter and now exceed \$16.15 billion. Loans grew at a relatively strong 1.8% for the quarter, and total nearly \$9.9 billion.

Many credit unions, however, are experiencing rapid asset growth, high loan delinquency and charge-offs, low or negative net earnings, and declining net worth ratios. Areas of regulatory concern identified in our analysis of the September 30, 2002, call report information include the following:

Earnings Deterioration

There are 35 credit unions reporting a year-to-date net loss at September 30, 2002, three fewer than at mid-year. Another 19 credit unions report very weak Return on Average Assets (ROA) ratios of 0.20% or less. The annualized aggregate ROA at September 2002 is 0.81%, up three basis points from June 30, 2002.

Earnings are a credit union's only source of net worth. Poor earnings performance jeopardizes the long-term viability of an institution, and should be a cause for serious concern to credit union officials.

Net Worth Erosion

The aggregate net worth ratio of Michigan state-chartered credit unions increased 15 basis points to 11.05% during the third quarter. 25 credit unions report net worth ratios below 8%, and no credit union had their net worth ratios decline by more than 20% over the last twelve months.

Asset Quality Concerns

Overall delinquency increased 2 basis points to 0.88% during the quarter. Charge-offs have leveled off. There were 24 credit unions with a net charge-off ratio over 1.5% at September 30, 2002, two more than June 2002.

Investments also remain an area of concern as general economic weakness continues. A number of corporate bond ratings have been downgraded, in some cases very quickly, and several issues are in default. Boards and management teams must exercise due diligence, including initial and ongoing credit analysis, to ensure that risks inherent in investment activities are properly managed.

High Asset Growth

The annualized asset growth rate for all Michigan state-chartered credit union is 9.6% at September 30, 2002, down considerably from the 13.3% reported at mid-year 2002. 21 credit unions report annualized asset growth over 20% at September 30, 2002, nearly half of the forty-one reported at June 2002.

Conclusion

Prudent risk management includes identifying and quantifying potential risks and adverse trends timely, and taking appropriate steps to ensure that risks are properly managed. Boards of directors and management teams must monitor the financial condition of their credit union on an ongoing basis to ensure satisfactory performance and safe and sound operations are maintained.

A written plan of action should be developed when adverse trends or financial conditions are identified. This plan of action serves to document your board's awareness of the problem and intended actions to control and correct the adverse conditions.

I hope the information in this letter is helpful in making informed business decisions. Operating a financial institution safely and soundly requires diligence in risk identification, measurement, and management. The stresses evident in the September 2002 statistics highlight the continuing need for the application of sound management practices in an uncertain economic environment.

Very truly yours,

Frank M. Fitzgerald
Commissioner